

KEEGAN WERLIN LLP

ATTORNEYS AT LAW
265 FRANKLIN STREET
BOSTON, MASSACHUSETTS 02110-3113

(617) 951-1400

TELECOPIERS:
(617) 951-1354
(617) 951-0586

October 25, 2005

Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station, 2nd Floor
Boston, MA 02110

Re: Boston Gas Company d/b/a KeySpan Energy Delivery New England, D.T.E. 05-66

Dear Ms. Cottrell:

On September 16, 2005, Boston Gas Company d/b/a KeySpan Energy Delivery New England ("Boston Gas" or the "Company") submitted its 2nd Annual Performance-Based Ratemaking ("PBR") Compliance filing to the Department of Telecommunications and Energy (the "Department"). In that filing, the Company requested that the Department allow Boston Gas to collect its under-recoveries of gas-related bad-debt expense either as an exogenous cost under the PBR Plan or through the Cost of Gas Adjustment ("CGA") rate. In accordance with the Department's notice and procedural schedule for the above-referenced proceeding, the Attorney General filed comments on the Company's proposal on October 20, 2005 ("AG Comments"). In this filing, KeySpan responds to the Attorney General's comments.

A. Exogenous Cost Recovery

The Attorney General states that the Department should reject the Company's request to recover "additional" gas-related bad debt costs either as an exogenous cost or through the CGA without a separate hearing in the CGA tariff proceeding (AG Comments at 2-3). With respect to exogenous cost recovery, the Attorney General claims that: (1) increases in the commodity price of gas are not unique to the local gas distribution industry (*id.* at 1); (2) increases in the cost of natural gas affect the economy in general and are therefore reflected in the GDP-PI formula (*id.* at 1-2); (3) the increase in bad-debt expense is not exogenous because it is within the control of the Company (*id.* at 2); and (4) the expense that the Company seeks to recover "is not a distribution rate related expense" and therefore is not subject to treatment as an exogenous cost under the PBR tariff (*id.*). However, these arguments contain an inherent inconsistency and inaccuracies that undermine the Attorney General's claims.

Specifically, the Attorney General first claims that increases in the commodity price of gas "are not unique to the local gas distribution industry" and that this would mean that "if the commodity cost of steel or plastic drives up the expense of gas mains and services the Company

uses . . . higher than the rate of GDP-PI, then the company could recover these expenses as ‘exogenous’” (AG Comments at 1-2, fn.1). However, to qualify for exogenous cost recovery, the Department’s standard requires that cost changes must be of the type “*uniquely affecting* the local gas distribution industry.” D.T.E. 03-40, at 490. Thus, the standard is not that increases in the cost of gas would apply only to the local gas distribution industry, but rather that the industry is “uniquely affected” by those cost changes. Increases in the commodity cost of gas have a unique affect on the local gas distribution industry because LDCs are the only entities that: (1) have an *obligation* to buy and resell natural gas to customers; (2) resell natural gas to retail customers *at no profit*; and (3) are without recourse to recover gas-related costs without authorization by the Department. Therefore, changes in gas and gas-related costs impose a unique burden on local gas companies.

Moreover, the issue here is not the collection of increases in gas costs. The Department allows actual gas costs to be recovered in the CGA on a reconciling basis. The issue here concerns the recovery of gas-cost related bad debt expense, which is unique to the local gas distribution industry because of the comprehensive regulatory framework that governs the Company’s ability to terminate service and to resort to other collection measures commonly available to unregulated companies.

Second, the Attorney General contends that increases in the cost of natural gas “affect the economy in general” and are therefore reflected in the GDP-PI formula (*id.* at 1-2). To support this claim, the Attorney General provides an affidavit of Timothy Newhard stating only that “based on my research and understanding, GDP-PI is effected by energy costs.” Affidavit of Timothy Newhard at 2. However, the standard is not whether the GDP-PI is affected by energy costs. Rather, the Department’s standard is whether the negative cost change requested as an exogenous cost is reflected in GDP-PI. The negative cost change in this case is the amount of gas-cost related bad debt expense incurred by the Company and not “energy costs” as suggested by the Attorney General. Although “energy costs” may influence the GDP-PI, gas-cost related bad-debt expenses are not a factor considered in establishing the GDP-PI.

In that regard, with the Department’s approval of the proposed PBR rates in this filing, the base rates established in D.T.E. 03-40 will have been adjusted by 3.76 percent (without compounding), or 1.47 percent in November 2003 and 2.29 percent in 2004. By comparison, total firm gas costs increased from \$317,591,172 to \$641,467,929 (on an annual basis) in the period between December 31, 2002 and December 31, 2004, which is an increase of 102 percent. Gas-cost related bad debt has increased in parallel with increases in gas costs with total gas-cost related bad-debt in the test year totaling \$5.1 million (as determined by the Department in D.T.E. 03-40) and \$14 million in the 12-month period January 1 through December 31, 2004, which represents an increase of 175 percent.¹ Thus, despite the Attorney General’s claim that GDP-PI is “effected by energy costs,” it is clear that the increased bad-debt expense is not captured in the 2004 GDP-PI rate of 2.7 percent experienced by the overall economy or the 2004 PBR adjustment of 2.29 allowed for the Company’s base distribution rates. To the extent that

¹ This compares to the increase in the Company’s total actual bad debt expense incurred in calendar year 2004 of \$21.6 million, which represents an increase of 132 percent over the \$9.3 million of test-year total bad-debt expense identified by the Department in D.T.E. 03-40.

increases in fuel costs influence the GDP-PI, those increases are affecting the cost of the Company's production inputs (the cost of which are recovered through base rates) and are not capturing the direct increase in gas commodity prices and the related bad-debt expense actually experienced by the Company.

Most importantly, even if the Attorney General's assertion is true, it is irrelevant in this case because the price-cap formula is applied *only* to base rates. Because gas-cost related bad-debt expense is not recovered through base rates, the expense is not increased by the inflation factor embodied in the price-path formula. In fact, the Attorney General's assertion that the 2.9 percent inflation factor reflects the increase in gas-related costs is inconsistent with his claim that exogenous cost treatment should be rejected because gas-related bad-debt expense is "not a distribution rate related expense" subject to treatment as an exogenous cost under the PBR tariff (AG Comments at 2). Therefore, since expenses that are not included in base rates are not adjusted annually by the GDP-PI, the application of exogenous cost principles to the treatment of such expenses should be made without regard to the factors that compose the GDP-PI.

Lastly, the Attorney General claims that the increase in bad-debt expense is not exogenous because it is within the control of the Company and it is not a "distribution rate related expense." There is no explanation for the *substantial* increase in gas-cost related bad-debt expense in the past two years other than the unprecedented increase in gas costs. The Attorney General provides no basis for the assertion that the gas-related bad-debt cost increase is "within the control of the Company" and the expense has increased dramatically along with revenues despite the Company's best efforts to pursue revenue recovery from customers. It is also important that the Company's ability to control these costs is significantly affected by the Department's billing and termination regulations. In fact, the Company's response to DTE-RR-132 in Bay State Gas Company, D.T.E. 05-27, showed that the Company's ratio of bad debt to revenues has remained relatively constant over the past eight years.

Moreover, the Department has never indicated that only "distribution rate related expense" are eligible for exogenous cost recovery. However, the Company would agree with the Attorney General's implicit recognition that, typically, gas-cost related bad-debt expenses are recovered through the CGA on a reconciling basis, and accordingly, would not need to be subject to exogenous cost recovery because cost increases would be properly provided for through the reconciliation process.

B. CGA Recovery

With respect to recovery through the CGA, the Attorney General claims that the CGA "formula" was set in KeySpan Energy Delivery, D.T.E. 03-40 (2003) and changes to the formula of a reconciling tariff that increase rates must be subject to a hearing before the Department under G.L. c. 164, § 94 (*id.* at 2) (citing, Consumers Organization for Fair Energy Equity, Inc. v. D.P.U., 368 Mass. 599, 606 (1975)). The Attorney General further claims that the Department "sets the method for the recovery of bad-debt expense" in base rate cases, and therefore, the Department has already "balanced company and customer interests when setting its rates under G.L. c. 194, § 94" (AG Comments at 2). Lastly, the AG states that "*if the Department determines that a separate tariff filing to modify the CGA formula and increase the CGA rate is*

appropriate, due process requires that customers in KeySpan's Boston Gas Company service area receive public notice of this type of proceeding and an adjudicatory proceeding" (*id.* at 3) (emphasis added).

The CGA formula was not set in D.T.E. 03-40. The CGA formula is a well-established calculation set forth in the Company's CGA tariff and this formula was not changed as a result of the Department's decision in D.T.E. 03-40. The Company currently recovers gas-cost related bad-debt expense on a reconciling basis in the CGA and no tariff filing or modification of the Company's existing CGA tariff would be required to recover its under-collections of gas-related bad-debt expense through the CGA. Specifically, Section 6.03 states that the Cost of Firm Gas Allowable for the CGAC "shall be comprised of a peak demand factor, a peak commodity factor, a *peak bad debt factor*, a peak other gas supply expense factor, and a peak working capital factor. Section 6.03(22) states that "Bad Debt Expense is the uncollectible expense attributed to Boston Gas ...gas costs." Section 6.08(e) states that "Costs Allowable Per Peak Bad Debt Formula shall be: costs associated with uncollected gas costs, including any applicable taxes, incurred by the Company to serve firm load in the Peak Season. In fact, the amount of bad-debt expense to be recovered through the bad-debt factor is not established by the CGA formula.

Therefore, the Company's request to recover its under-collections of gas-related bad-debt expense is not a "request for a change in the way the Department calculates KeySpan's bad-debt expense," nor is it "effectively a change in the CGA formula." The CGA formula is specified in the CGA tariff to include a bad-debt component (on a reconciling basis). The *amount* to be recovered through the bad-debt component is not part of the formula and is a determination subject to the Department's discretion.

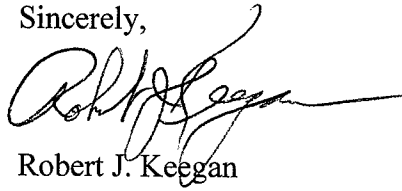
To that end, the Supreme Judicial Court has found that adjustments to the CGAC for costs incurred by the utility are "well within the [D]epartment's general supervisory authority over utility costs, see G. L. c. 164, s. 76, and [*sic*] consistent with its "broad authority to determine ratemaking matters in the public interest." Fitchburg Gas and Electric Light Company v. Department of Telecommunications and Energy, 440 Mass. 625 (2004), at 637-638 ("Fitchburg"); *citing* Massachusetts Inst. of Tech. v. Department of Pub. Utils., 425 Mass. 440 Mass. 856, 868 (1997). [footnote omitted]. In Fitchburg, the Court stated that "the 'dollars and cents' amount inserted into the flow-through formula is presumptively not fixed. They represent costs over which utilities often have little bargaining power or control, and it would defeat the very purpose of a CGAC to require these costs to be frozen until the expensive and cumbersome process of a rate change hearing is completed. Fitchburg, 550 Mass. at 638, *citing*, Consumers Org. for Fair Energy Equality, Inc. v. Department of Pub. Utils., 368 Mass. 599, 606-607 (1975) (it would be "incongruous" to require a s. 94 rate proceeding before passing cost fluctuations onto ratepayers, because "the clauses were designed precisely to avoid those proceedings except where changes were being proposed in the clauses themselves").

In this case, the Company is proposing no change to the CGA clause, no change to the CGA tariff and no change to the CGA formula set forth in the tariff. The Company is requesting only to recover the "dollars and cents amount" of under-collected gas-cost related bad-debt expense actually incurred as a result of recent gas cost increases. The Company's customers and the participants in D.T.E. 03-40 were provided notice in this proceeding of the proposal to

recover the existing under-collection of gas-related bad-debt expense either as an exogenous cost or as part of the normal reconciliation process in the CGA. Pursuant to that notice, the Department has afforded an opportunity for comment to all interested parties. Therefore, allowing the recovery of gas-cost related bad-debt expense on a reconciling basis through the CGA is an action squarely within the discretion of the Department pursuant to its general supervisory authority over utility costs in G.L. c. 164, § 76.

The Company sincerely appreciates the opportunity to comment on these important issues.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert J. Keegan", with a long horizontal flourish extending to the right.

Robert J. Keegan

cc: Service List